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Nos. 87-453 and 87-464

In the Supreme Court of the United States

OCTOBER TERM, 1988

AMERADA HESS CORPORATION *et al.*,
Appellants,
v.
DIRECTOR, DIVISION OF TAXATION,
Appellee.

TEXACO INC. and TENNECO OIL COMPANY,
Appellants,
v.
DIRECTOR, DIVISION OF TAXATION,
NEW JERSEY DEPARTMENT OF THE TREASURY,
Appellee.

ON APPEALS FROM THE SUPREME COURT OF NEW JERSEY

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE, THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE CHAMBER OF COMMERCE OF THE UNITED STATES AS *AMICI CURIAE* IN SUPPORT OF APPELLANTS

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INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce, the National

Association of Manufacturers and the Chamber of Commerce of the United States of America as *amici curiae* in support of the appellants in the above-captioned cases. Written consents of the appellants and the appellee have been obtained and filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

The Council of State Chambers of Commerce ("COUNCIL"), organized in 1932, consists of 40 Chambers of Commerce. The Committee on State Taxation ("COST"), one of the three advisory committees of the COUNCIL, consists of 274 corporate members which conduct a substantial portion of the interstate commerce of United States taxpayers. One of COSTS's principal activities has been to work with the states and others toward developing fair and equitable standards of state taxation.

The National Association of Manufacturers of the United States of America ("NAM") is a non-profit, voluntary business association incorporated under the laws of the State of New York. The NAM represents more than 13,000 companies, large and small, located in every state. Further, NAM is affiliated with an additional 158,000 businesses through the Associations Council and the National Industrial Council. The membership of the NAM represents an estimated 80 percent of all goods manufactured in the United States.

The Chamber of Commerce of the United States ("CHAMBER") is the largest federation of business organizations and individuals in the United States. Current CHAMBER membership includes more than 180,000 corporations, partnerships and proprietorships, as well as several thousand trade associations and state and local chambers of commerce. The CHAMBER regularly advocates its members' views in court on issues of national concern to the American business community.

Member companies of COST, NAM and the CHAMBER are representative of that part of the nation's business sector which is most directly affected by state taxation of interstate operations. These members include most of the appellants and other oil companies, as well as companies engaged in a diverse range of manufacturing, retailing and financial pursuits. COST, NAM and the CHAMBER are, therefore, vitally interested in cases such as this one which present issues significantly affecting state taxation of interstate commerce.

INTRODUCTION AND SUMMARY OF ARGUMENT

The American public continually puts its elected representatives in a no-win situation: everybody wants more public services but nobody wants to pay for them. The legislator who balks at expanding increasingly expensive public services is vilified as lacking in compassion. If the same legislator raises taxes to pay for those services, he or she is certain to encounter voter hostility at election time. Faced with these twin pressures, state representatives inevitably welcome methods of raising revenue that impose a disproportionate share of the tax burden on businesses and voters that are safely out-of-state.

Many of the most obvious routes to extraterritorial taxation have already been closed off by this Court. For example, New Hampshire's "commuter" income tax imposed exclusively on nonresidents was invalidated in *Austin* v. *New Hampshire*, 420 U.S. 656 (1975), and New York's allowance of personal exemptions for residents only was invalidated in *Travis* v. *Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920). In the corporate area, states have been precluded from assessing facially neutral, "flat" taxes that have the effect of imposing disproportionate burdens

on interstate corporations, *American Trucking Ass'ns* v. *Scheiner*, 107 S. Ct. 2829 (1987), and from selecting apportionment formulas that attribute an intrinsically disproportionate share of corporate income to the taxing state. *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 121 (1931).

The present case challenges New Jersey's novel method of exporting the state's tax burden: New Jersey disallows deductions for certain costs which are necessarily incurred out-of-state.

Superficially, the New Jersey taxation scheme has the appearance of a standard formula apportionment calculation. Under the New Jersey Corporation Business Tax Act (1945), N.J. Stat. Ann. §§ 54:10A-1 *et seq.* (West 1986) ("CBT"), a multistate corporation multiplies its net income — wherever earned — by a three-factor apportionment formula to yield the amount of the company's net income that is attributable to New Jersey. N.J. Stat. Ann. § 54:10A-6 (West 1986).[1]

The New Jersey taxation scheme diverges from the ordinary in its definition of "net" income. As to most taxpayers, the CBT taxes only net income, meaning that taxpayers deduct from gross receipts their costs and expenses, including, *inter*

[1] New Jersey's apportionment formula is the average of the following three fractions:

$$\frac{\text{in-state receipts}}{\text{total company receipts}}; \quad \frac{\text{in-state payroll}}{\text{total company payroll}}; \text{ and } \quad \frac{\text{in-state property}}{\text{total company property}}.$$

This calculation yields a rough approximation of how much of a company's total operations and resources are in New Jersey. To take a simplified example of how the process works, if a unitary business's total net income from its operations throughout the country is $100, and, based on the apportionment formula, an average of one quarter of its receipts, payroll and property are found in New Jersey, then the company's New Jersey taxable income is $25. The New Jersey corporate tax rate of 9 percent is then applied to the $25 of New Jersey taxable income for a tax due to the state of $2.25. N.J. Stat. Ann. §§ 54:10A-5, 54:10A-6 (West 1986).

alia, the cost of severance taxes.[2] However, as to taxpayers who are required to pay the crude oil windfall profit tax of 1980, 26 U.S.C. §§ 4986 *et seq.* (the "WPT"), what New Jersey calls "net" income is not really net income at all, because those taxpayers are required to "add back" to their net incomes the cost of the WPT. N.J. Stat. Ann. § 54:10A-4(k)(2)(C) (West 1986).[3]

The immediate effect is readily apparent: the WPT is a federal excise tax triggered by the removal of crude oil from the vicinity of the well. I.R.C. § 4986(a); Treas. Reg. § 51.4996-1(d)(1). There are no oil wells in New Jersey. Indeed, the State has no proven reserves of crude oil at all.[4] Hence, New Jersey has managed to *add an element* to net income which *cannot* burden in-state activity. The burden of the add-back requirement must fall entirely on out-of-state activity, just as surely as would a requirement that oil and gas companies add back all expenses incurred in Texas and Louisiana.

The domestic attractiveness of such a taxation scheme is undeniable. Through the add-back requirement, New Jersey denies the deductibility of a very substantial cost which *cannot* be incurred in-state. In so doing, the State has admittedly raised approximately $88 million in revenue[5] without imposing

[2] Net income under the CBT is based on the federal definition of net income. N.J. Stat. Ann. § 54:10A-4(k) (West 1986). As such, the CBT allows the deduction of severance taxes, which are treated for federal tax purposes as deductible business expenses or costs of goods sold. *See* 2 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶32.2.3 at 32-17 to 32-18 (1981).

[3] On its face, the CBT requires the add back of all federal "profits or income" taxes. N.J. Stat. Ann. § 54:10A-4(k)(2)(C) (West 1986). In fact, the only so-called "profits or income" tax which is deductible for federal income tax purposes — and thus the only item which is added back under this provision — is the WPT.

[4] U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585 (1986).

[5] Motion to Dismiss or Affirm, at 11 n.8. The $88 million figure is exclusive of interest on those funds over the preceding eight years.

a single dime of additional tax burden on in-state activity. Moreover, and in this the State must truly be given credit for creativity, the add-back requirement makes a virtue out of scarcity. The very fact that New Jersey has no crude oil is what makes the scheme work.[6]

The factors that make New Jersey's scheme locally attractive make it dangerous from the perspective of the nation. If all it takes to export a state's tax burden is to identify some resource that the state does *not* have, then most states can do that, and many more surely will. The specter of state governments being financed by increasingly unrepresentative taxes is a serious one: our constitutional system presumes that those taxed are represented in the taxing authority. To the extent that presumption is invalid, the legitimacy of the system breaks down.[7]

Of equal importance, New Jersey's taxation scheme is dangerous because it exploits the existing tensions between

[6] New Jersey has asserted that the challenged taxation scheme was not ill-motivated. This assertion is irrelevant. To be sure, the legislature had no intent with respect to the WPT when it enacted the add-back provision in 1958. On the other hand, it was not the legislature that construed this provision as applying to the WPT; it was a state administrative official, the Director of the Division of Taxation. Whether the Director's interpretation was motivated by his dispassionate reading of the statute or by a desire to raise revenue at the expense of interstate commerce is simply beside the point.

[7] The economic efficiency of the system also breaks down to the extent tax burdens are exported out-of-state. When the individuals and businesses that stand to benefit from the state's expenditure of funds are the same people who have to foot the bills, some rough equilibrium will be reached between what the state's residents want and what they are willing to pay for. The conflicting demands for more services and lower taxes are simply the working out in the political forum of the same forces of supply and demand more readily recognized in the private market. In economic terms, the correct or "efficient" level of both taxes and public services will be reached only if the residents of the state have to pay their own bills. If New Jersey can compel business activities in Louisiana to shoulder a disproportionate amount of New Jersey's tax burden, then New Jersey's level of spending will be higher and Louisiana's will necessarily be lower than if each state had to fund its proper amount of its own spending.

the states over the distribution of natural resources. The Framers were deeply concerned that the union could be torn apart by resentments and rivalries between the states. The prescience of their concerns has been borne out in this area as in so many others. The rivalries between the oil-exporting states and the oil-importing states are only one example. Through its tendency to exploit disparities in resources between the states, the New Jersey taxation scheme threatens to create a balkanized confederacy of retaliatory tax regions.

The Commerce and Due Process Clauses were adopted by the Framers to inhibit these centrifugal tendencies. The challenged tax should be invalidated under the Due Process and Commerce Clauses because it is not "fairly calculated" to attribute to New Jersey only the State's "fair share" of the taxpayers' incomes. *Butler Bros.* v. *McColgan*, 315 U.S. 501, 506 (1942); *Freeman* v. *Hewitt*, 329 U.S. 249, 253 (1946). In addition, the challenged tax violates the Commerce Clause by singling out out-of-state activity for disfavored tax treatment. In so doing, the New Jersey taxation scheme threatens central Commerce Clause values: the prevention of "economic Balkanization," *Hughes* v. *Oklahoma*, 441 U.S. 322, 325-26 (1979), and the preservation of the "national free trade area." *American Trucking Ass'ns*, 107 S. Ct. at 2841; *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 328-29 (1977).

ARGUMENT

I. New Jersey's Taxation Scheme Is Calculated to Attribute to New Jersey More Than Its "Fair Share" of Multistate Corporate Income.

The fundamental criterion for judging the constitutionality of a state's taxation of a unitary, multistate business is that the

state's tax code must be reasonably calculated to attribute to that state only its fair share of the business's income. *See, e.g.*, *Butler Bros*, 315 U.S. at 506 (method of calculation must be " 'fairly calculated' to assign to [the state] that portion of the net income 'reasonably attributable' to the business done there"); *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 169 (1983) (apportionment formula must be "fair," meaning that, *inter alia*, the "factors used . . . must actually reflect a reasonable sense of how income is generated"); *Freeman* v. *Hewitt*, 329 U.S. at 253 (interstate commerce can be required to pay only its "fair share" of costs of local government). A state taxation scheme that is calculated to assign to the state more than its fair share of the unitary taxpayer's income violates not only the taxpayer's due process rights, but also the Commerce Clause by " 'exacting more than a just share from the interstate activity.' " *Tyler Pipe Indus., Inc.* v. *Washington State Dep't of Revenue*, 107 S. Ct. 2810, 2820 (1987), *quoting Washington Dep't of Revenue* v. *Association of Washington Stevedoring Cos.*, 435 U.S. 734, 738 (1978).

As corollaries to this fundamental principle, once a state has shown that its tax code is, on its face and in practical effect, reasonably calculated to attribute to the state its fair share of interstate corporate income, the state has essentially satisfied its constitutional obligations; that is, it has no duty to ascertain that its taxation provisions actually yield the state its "correct" share of a corporation's income, as measured by geographical accounting or any other method. *Container Corp.*, 463 U.S. at 182.

Equally, once the taxpayer has shown that the state's taxation scheme is not reasonably calculated to reach a fair result, the taxpayer has met its burden, and need not show that the result generated by applying the state's tax code to the corporation is substantially at variance from a hypothetical "correct" out-

come.[8] *See F.W. Woolworth Co.* v. *Taxation and Revenue Dep't*, 458 U.S. 354, 372-73 (1982) (New Mexico's requirement that corporate taxpayers add to their net incomes "fictitious" gross-up amounts "deemed received" from non-unitary subsidiaries invalidated without consideration of extent of the disproportion created by the requirement). *See also Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 269 (1984) ("[i]t is well settled that '[w]e need not know how unequal the Tax is before concluding that it unconstitutionally discriminates' "), *quoting Maryland* v. *Louisiana*, 451 U.S. 725, 760 (1981).

New Jersey's definition of "net income" is not reasonably calculated to assign to New Jersey its fair share of the taxpayers' incomes because it disallows the deduction of a cost which is and can be incurred only out-of-state. Accordingly, disallowance of WPT costs will raise the amount of corporate income attributable to out-of-state activities while not imposing any additional tax burdens on in-state activities.

The New Jersey CBT would no more be reasonably calculated to reach a fair result if it explicitly denied deductions for expenses incurred out-of-state, such as if it explicitly singled-out for denial the deductibility of costs incurred in the construction of buildings in New York. Such an exclusion would be more brazen, but its effect would be identical. Indeed, if New Jersey's view as to its unlimited power to define "net income" were correct, it would follow that even such blatant exclusions from deductible expenses would be constitutionally permissible. That surely is not the case.

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[8] While a taxpayer may, in the alternative, prevail by demonstrating that, as applied to itself, even a fair formula has yielded a greatly disproportionate outcome, *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 121 (1931), the interest of the *amici* is in the constitutionality of New Jersey's taxation scheme itself, not in the quantitative result as applied to particular taxpayers.

Even if New Jersey could deny the deductibility of all building construction expenses, the Constitution requires that, if some construction costs are deductible, other construction costs which can arise only out-of-state also must be allowed. In the instant case, New Jersey allows the taxpayer to deduct from its gross receipts the costs and expenses of doing business, including severance taxes. The singling-out of a particular cost, which can be incurred only out-of-state, is by definition not geared to reaching a fair result.[9]

New Jersey's repeated insistence that appellants have not proven the *amount* by which the challenged law overstates New Jersey's share of their incomes, or that such amount was excessive, is therefore a *non sequitur* that betrays a misapprehension of the fundamental principles discussed above. The challenge here is to New Jersey's right to require the add back of the WPT tax expense *at all*. This requirement is patently calculated to accord to New Jersey more than its fair share of the taxpayers' incomes.

[9] The Solicitor General states that he has some difficulty in determining whether the WPT is more like a severance tax than an income tax. We fail to see the problem. For all the reasons stated in the Brief for the United States at 25-28, the WPT looks like a severance tax, operates like a severance tax and was intended as a severance tax. It simply bears no resemblance to the federal income tax. The fact that New Jersey has labeled it an "income or profits" tax is irrelevant: New Jersey can call the WPT a gift tax if it chooses. The constitutional analysis is not affected one whit by the labels chosen by a state. *See McLeod* v. *J.E. Dilworth Co.*, 322 U.S. 327, 331 (1944) (state court cannot " 'render valid, by misdescribing it, a tax law which in substance and effect was repugnant to the Federal Constitution' "). *Cf. Tyler Pipe*, 107 S. Ct. at 2820 ("[t]he fact that the B&O tax 'has the advantage of appearing nondiscriminatory' . . . does not save it from invalidation"). A state tax is judged by what it is, not what it is called.

II. New Jersey's Add-Back Requirement Discriminates Against Interstate Commerce.

New Jersey's add-back requirement disallows the deduction of a particular cost that *cannot* be incurred in New Jersey. One would think that merely to describe this requirement is to demonstrate that it discriminates against interstate commerce, just as surely as if New Jersey explicitly required taxpayers to add back *all* costs and expenses that are incurred outside the state.

As discussed below, the dangers inherent in the New Jersey taxation scheme are precisely those at which the Commerce Clause was directed: "economic Balkanization;" disproportionate burdening of out-of-state activities; and obstruction of the "national free trade area." New Jersey ignores these dangers, asserting that the Commerce Clause applies only where a state bestows the fruits of its discrimination on a particular local industry. This interpretation ignores the central purposes of the Framers in adopting the Commerce Clause, as well as numerous decisions of this Court in interpreting it.

A. *The New Jersey Taxation Scheme Provokes "Economic Balkanization" by Exploiting Disparities Between the States.*

The central concern of the Framers in adopting the Commerce Clause was to prevent "economic Balkanization" of the states. *Hughes* v. *Oklahoma*, 441 U.S. 322, 325-26 (1979). The Framers were all too aware of the "drift toward anarchy and commercial warfare between [the] states" under the Articles of Confederation. *H.P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 533 (1949). In sound reaction to the " 'mutual jealousies and aggressions of the States, taking form in customs barriers and other economic retaliation,' " *Baldwin* v. *G.A.F.*

Seelig, Inc., 294 U.S. 511, 522 (1935), *quoting* 2 Farrand, *Records of the Federal Convention* 308 (1911), the Framers formulated the Commerce Clause to "provide for the harmony and proper intercourse among the states." The Federalist No. 41, at 291-92 (J. Madison) (H. Dawson ed. 1863). Among other things, the Commerce Clause was intended to restrain "the desire of the commercial states to collect, in any form, an indirect revenue from their uncommercial neighbors. . . ." *Id.* at 292.[10]

When one considers the uneven distribution of natural resources between the various states and regions of this nation, it is clear that New Jersey's effort "to collect . . . an indirect revenue from . . . [its] neighbors" will tend to create just the sort of "economic Balkanization" feared by the Framers. New Jersey's add-back requirement exploits the uneven distribution of natural resources by making a tax advantage out of the State's lack of crude oil. This is a clever maneuver, and may afford the State an immediate financial benefit, but it is a street that goes both ways. Louisiana and Oklahoma are equally

[10] As explained by Justice Jackson, the heavy taxes imposed by the Colony of New York on the commercial activities of its neighbors, and the resulting retaliatory measures, were a dominant force behind the adoption of the Constitution:

> The unedifying story of Colonial rivalry in preying upon commerce, which more than any one thing made our Federal Constitution a necessity, is too often told by historians to justify repetition. . . . In 1787 New York was being supplied with firewood from Connecticut and much farm produce from New Jersey. It seized upon "local incidents" to lay a tax. Every sloop which came down through Hell Gate . . . and every market boat rowed across the Hudson River had to pay heavy entrance duties. Then came retaliatory measures. . . . These chronic quarrels were destroying the trade of all the rivals, and it was sought by the Constitution to free trade from local burdens and controls.

Independent Warehouses, Inc. v. *Scheele*, 331 U.S. 70, 94 (1947) (Jackson, J., dissenting).

capable of identifying resources which they lack but which are present in New Jersey, and of disallowing deductions for costs associated with the production of those resources.

It takes little imagination to see that if New Jersey is permitted to raise $88 million solely at the expense of out-of-state activities, then other states will seek to do the same. If New Jersey can refuse to recognize deductions for oil tax costs, then Alaska, a national leader in oil production, may seek to disallow deductions for expenses incurred in computer and data processing services, which are negligible factors in Alaska's economy.[11] Similarly, if New York, which has no coal production,[12] can refuse to allow deductions for coal severance taxes, then the coal-producing states may disallow deductions for stock transfer taxes, which at times have been a "source of substantial revenue" for New York. 1 J. Hellerstein, *State Taxation* 145 (1983).[13]

The regional rivalries of our time — Sun Belt versus Rust Belt, oil-producing states versus oil-importing states — would be foreign to the Framers, but the spectacle of states using their natural advantages and disadvantages to extract benefits from their sister states would be depressingly familiar and

[11] U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585, 611 (1986). Alaska, the nation's second-largest producer of petroleum, *id.* at 585, has only 28 business establishments involved in computer and data processing services, fewer than any other state in the nation. *Id.* at 611 (1982 data). In 1982 alone, receipts from such services in New Jersey totalled $1.2 billion, *88 times* the amount of such receipts in Alaska. *Id.* at 612.

[12] U.S. Department of Commerce, *State and Metropolitan Area Data Book* 585 (1986).

[13] The New York stock transfer tax, N.Y. [Tax] Law § 270 (McKinney 1986) is imposed, *inter alia*, on all sales of securities occurring within New York, which necessarily includes all sales on the New York Stock Exchange. There are no stock exchanges in the major coal-producing states — West Virginia, Kentucky, Wyoming — and, not surprisingly, there are no stock transfer taxes in those states either. *See U.S. Department of Commerce, State and Metropolitan Area Data Book* 585 (1986); Hellerstein, *supra* at 20-21.

would be readily recognized as part of that class of conduct which it was the purpose of the Commerce Clause to eliminate. *See* The Federalist No. 22, at 140 (A. Hamilton) (H. Dawson ed. 1863).

B. *New Jersey's Disproportionate Taxation of Out-of-State Activities Compels Intense Scrutiny Under the Commerce Clause.*

State laws which disproportionately burden out-of-state activities are a particularly fertile source of interstate rivalries and reprisals. Burdened outsiders, having little influence on the taxing state, inevitably turn to their own states for redress, giving rise to continuing cycles of retaliatory state laws. As this Court recognized in invalidating New Hampshire's "commuter" income tax:

> Since nonresidents are not represented in the taxing State's legislative halls . . . judicial acquiescence in taxation schemes that burden them particularly would remit them to such redress as they could secure through their own State; but "to prevent [retaliation] was one of the chief ends sought to be accomplished by the adoption of the Constitution."

Austin v. *New Hampshire*, 420 U.S. 656, 662-63 (1975), *quoting Travis* v. *Yale & Towne Mfg. Co.*, 252 U.S. 60, 82 (1920).

For this reason, scrutiny under the Commerce Clause is particularly heightened where the burden of the challenged state law "bears disproportionately on out-of-state residents and businesses." *Kassel* v. *Consol. Freightways Corp.*, 450 U.S. 662, 675-76 (1981) (invalidating Iowa truck-length limitations which disproportionately burdened out-of-state carriers). *See also Raymond Motor Transp., Inc.* v. *Rice*, 434 U.S. 429, 447 (1978); *Southern Pacific Co.* v. *Arizona*, 325 U.S. 761, 767-68 n.2 (1945).

Of all the possible ways in which a state can disproportionately burden out-of-state activities, unrepresentative state taxation schemes pose the greatest dangers of inciting reprisals and retaliation. For example, Texas might or might not be willing to enact its own truck-length limitation in retaliation for an Iowa limitation that adversely affected Texan trucking companies. On the other hand, all states always have an interest in raising taxes, particularly if the increase can be imposed on exclusively out-of-state activities. The oil-producing states would need little encouragement to impose retaliatory taxes against New Jersey if such taxes could constitutionally be assessed solely on activities conducted in New Jersey.

State taxes which disproportionately burden out-of-state activities are not only more dangerous than similarly discriminatory state regulations, they are also less entitled to the traditional deference accorded to state enactments. Because "revenue serves as well no matter what its source," *Freeman* v. *Hewitt*, 329 U.S. 249, 253 (1946), it is fair to presume that the *only* reason a state would have for singling out out-of-state activity for particular tax burdens is to lessen the burden on local activities.[14] The ordinary presumption that a state has a valid reason for enacting a regulation is therefore entitled to

[14] New Jersey's hypothetical regarding the disallowance of expenses incurred in casino gambling, Brief of Appellee in Response to the United States, at 9, may be the exception that proves this rule. There may be situations in which a state has a genuine moral or other policy basis for denying a deduction which happens to arise exclusively out-of-state. Whether the disallowance of such deductions is constitutionally permissible need not be considered here, although we daresay that New Jersey would be the first to cry foul if a sister state were to deny the deductibility of casino-related expenses. In any event, this example serves to highlight the lack of any legitimate state interest in the present add-back requirement.

little if any weight in the field of taxation. This heightened scrutiny over state tax laws entirely distinguishes the present case from *Exxon Corp.* v. *Governor of Maryland*, 437 U.S. 117 (1978), on which the state has so heavily relied.[15]

C. *The New Jersey Taxation Scheme Threatens to Obstruct the "National Free Trade Area" by Discouraging Interstate Corporations From Doing Business in New Jersey.*

The New Jersey add-back requirement also threatens another central goal of the Commerce Clause: the creation of a "national

[15] Regulations imposed under the state's police power are accorded more deference than state tax laws because there may well be circumstances in which a substance or practice which happens to originate exclusively outside the state is legitimately deemed by the state to constitute a threat to the health or safety of its population. A state is not precluded from regulating or banning a dangerous product simply because of the happenstance that the product is not produced locally. By contrast, revenue raised outside the state is by definition precisely equal in quality to that raised locally. This rather obvious distinction between the state's regulatory authority and the state's taxation authority demonstrates the inaptness of the State's reliance on *Exxon*. In *Exxon*, the Court ruled that Maryland could rationally conclude that the prohibited form of ownership had contributed to inequities in the distribution of an essential resource during a time of shortages. *Id.* at 121, 124-25. Having accepted Maryland's asserted rationale, it required no great leap to uphold the regulation despite its exclusive burden on out-of-state companies. By analogy, if Maryland had reasonably concluded that a particular chemical was too dangerous to be permitted in-state, a ban on that chemical would surely be legitimate even if its sole source was out-of-state. By contrast, New Jersey cannot assert that revenue derived from taxing out-of-state activities serves any legitimate need of the State better than nondiscriminatorily raised revenue. *See Freeman* v. *Hewitt*, 329 U.S. at 253 (because state has no need for revenue from a particular source, taxation of interstate commerce has "always been more carefully scrutinized and more consistently resisted than police power regulations of aspects of such commerce"). *Cf. Bacchus Imports*, 468 U.S. at 272 (while states may compete for a share of interstate commerce, they may not use their taxation powers as the means toward that end).

free trade area." *American Trucking*, 107 S. Ct. at 2841. *See also Boston Stock Exchange*, 429 U.S. at 328, *quoting McLeod*, 322 U.S. at 330 ("'[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States'"); *Maryland* v. *Louisiana*, 451 U.S. 725, 754 (1981).

As explained by Judge Posner, when states "export their tax burdens" by imposing disproportionate tax burdens on multistate businesses, the interstate business is

> compelled to pay a higher tax than if it operated in only one state . . . . The result is to create an inefficient incentive to do business in as few states as possible.

R. Posner, *Economic Analysis of Law* 608 (3d ed. 1986). In the "national free trade area" created by the Commerce Clause, state boundaries are to be "economically irrelevant." *American Trucking*, 107 S. Ct. at 2840-41. State taxes which, like New Jersey's add-back requirement, impose disproportionate burdens on out-of-state activity, make state boundaries not only relevant but all-important, thereby discouraging interstate corporations from doing business in the taxing state. Even the most financially secure of the members of the *amici* organizations could not continue doing business in all fifty states if each state were to impose substantially disproportionate taxes on exclusively out-of-state activities.

D. *New Jersey's Restrictive Interpretation of the Commerce Clause Ignores Its History, Its Purposes and Its Interpretation by this Court.*

The New Jersey Supreme Court shrugged off the serious threats to Commerce Clause values posed by the add-back

scheme, asserting that there is no discrimination against interstate commerce unless the state favors a local industry similarly situated to the disfavored out-of-state businesses.[16] Under New Jersey's view, New Jersey could disallow the deduction of *any* cost incurred in, say, Texas: the *generalized* benefit to the entire state in reducing all in-state tax bills does not count, according to the State, as "discrimination," because there is no particular in-state industry being favored. New Jersey thus reduces the Commerce Clause to an equal rights act as between local and out-of-state industries. This reading of the Commerce Clause ignores its central purposes, as discussed above, and is flatly inconsistent with numerous decisions of this Court. Indeed, it is unimaginable that the narrow meaning suggested by New Jersey would be all there is to the clause which, after all, was "[t]he sole purpose for which Virginia initiated the movement which ultimately produced the Constitution." *H.P. Hood*, 336 U.S. at 533.

New Jersey's argument, in essence, is that the applicability of the Commerce Clause depends on what the state *does* with the fruits of its discrimination. New Jersey asserts that the Commerce Clause is not implicated unless those benefits are bestowed upon a particular local industry as opposed to being spread among the state's citizenry as a whole. The basis for such a distinction is nowhere found in the history or purposes of the Commerce Clause. To the contrary, the tendency of New Jersey's unrepresentative tax to promote "economic Balkanization" and to endanger the national free trade area is every bit as great as if the benefits were directed to a particular local industry. *See South Carolina State Highway Dep't* v. *Barnwell Bros., Inc.*, 303 U.S. 177, 184 n.2 (1938).[17]

[16] Appendix A to Jurisdictional Statement of Amerada Hess Corporation Appellants at 34a.

[17] The State's argument that the Commerce Clause is aimed *only* at rectifying unfairness between particular competitors is strikingly foreign to our ordinary understanding of the role of public law in our private enterprise system. Generally, we expect public law to intervene in disputes between private competitors only in the service of some greater public interest. For example, the antitrust laws protect competition, not competitors. *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977). One can imagine a state arguing that constitutional values are not implicated when what is at stake is only a dispute between private competitors. But for New Jersey to argue that Commerce Clause values cannot be vindicated unless one private competitor has obtained an unfair advantage over another seems like the tail wagging the dog. *See Exxon Corp.* v. *Governor of Maryland*, 437 U.S. 117, 127 (1978) ("the [Commerce] Clause protects the interstate market, not particular interstate firms . . .").

The ultimate proof of the error in New Jersey's interpretation is that it is flatly inconsistent with numerous decisions of this Court. State laws have frequently been invalidated under the Commerce Clause without there being any particular local competitor favored by the offensive regulation, but merely a generalized benefit to the state as a whole. Most strikingly, in *City of Philadelphia* v. *New Jersey*, 437 U.S. 617 (1978), New Jersey made the very same argument it makes here: that the Commerce Clause was not implicated by the State's ban on the disposal of wastes from outside the State because " '[n]o New Jersey commercial interests stand to gain advantage . . . as a result of the ban. . .' " *Id.* at 626 (*quoting* New Jersey's brief). The Court rejected this argument out-of-hand as irrelevant. *Id.* The Commerce Clause was violated by the State's creation of a benefit to its citizenry as a whole at the expense of its sister states. *Id.* at 626-28. *City of Philadelphia* v. *New Jersey* presented the strongest possible case for New Jersey's proposed rule: not only was there no local industry *favored* by the waste disposal ban, it was in-state business — the local owners of waste disposal sites — that suffered the pecuniary losses created by the regulation. *Id.* at 626. The State's argument failed there and must also fail here: a state enactment can discriminate against interstate commerce without discriminating in favor of a particular local industry.

Similarly, in *Tyler Pipe*, the Court held that Washington's manufacturing tax exemption "discriminates against interstate commerce," 107 S. Ct. at 2820, even though it was local industry which, far from being favored by the tax scheme, had to pay the "double" tax. In *Tyler Pipe*, the same local manufacturer paid lower taxes when selling in-state than when selling out-of-state: as here, the forbidden discrimination created by the taxation scheme was against interstate activity itself. *See also Westinghouse Electric Corp.* v. *Tully*, 466 U.S. 388, 393 (1984) (New York's export tax credit discriminated against out-of-state activity and created general benefit to State by offering tax exemption for only those exports shipped from New York; no particular in-state industry was favored because the same taxpayer — local or out-of-state — paid less tax to the extent it shipped from New York); *Bacchus Imports*, 468 U.S. at 268 n.8 (1984).

It is true that the cases have often described discriminatory taxes as favoring local businesses. *See, e.g., Boston Stock Exchange*, 429 U.S. at 329; *Maryland* v. *Louisiana*, 451 U.S. at 754; *Bacchus Imports*, 468 U.S. at 268. Those descriptions, however, were written in a different context: they applied to cases in which the state was trying to use its taxation system to promote some social goal other than raising revenue: e.g., discouraging sales on regional, out-of-state stock exchanges, *Boston Stock Exchange*, 429 U.S. at 331; promoting investment in in-state mineral exploration, *Maryland* v. *Louisiana*, 451 U.S. at 757; and encouraging development of the local liquor industry, *Bacchus Imports*, 468 U.S. at 265. The opinions in those cases appropriately were limited to the circumstances they presented. The New Jersey tax challenged here, by contrast, is aimed very simply at raising revenue, albeit in a discriminatory manner. Discrimination is as possible and as much prohibited when the state uses its tax system simply to raise revenue as when it employs its tax code in the service of some other social goal. The formulaic approaches suitable to the latter situations, however, may not be applicable in the former context.

Apparently as a consequence of the obvious unfairness and discrimination against interstate commerce created by its add-back requirement, the State has been reduced to arguing that, if the Court disallows New Jersey's blatantly discriminatory add-back requirement, there may be line-drawing problems in future cases where the discrimination is less blatant. That argument requires little response. As an initial matter, the present case poses no line-drawing problems. There is no crude oil production in New Jersey, and, absent some geological breakthrough, there never will be. Thus, there is no question here of de minimis exceptions or of likely changes in the future.

As for the possibility that future cases will require line-drawing judgments, that fact does not distinguish this case from the vast majority of cases decided by this Court. Almost every rule of law enunciated by this Court creates the possibility that lower courts will have to engage in line-drawing to apply the law to the facts of future cases. The judgments that may be required by the various hypotheticals presented by the State are in no respect exceptional, nor do they present any challenges not surmountable by the standard judicial methods for resolving such issues, namely presumptions, burdens of proof, de minimis exceptions, threshold showings, and so forth.

The New Jersey add-back requirement is a blatant discrimination against out-of-state activity that allows New Jersey to shift a substantial amount of its tax burden to business activities which are necessarily performed in other states. In the words of Justice Jackson: "If [this tax] is valid, I know of no reason why the community should bear any of its own tax burdens." *Independent Warehouses, Inc.* v. *Scheele*, 331 U.S. 70, 95 (1947) (Jackson, J., dissenting).

CONCLUSION

The judgment of the Supreme Court of New Jersey should be reversed.

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